FILED
OCT 5 1961
JAMES R. BROWNING, CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1961

No. 470

ALBIN C. HALQUIST and
MADELINE E. HALQUIST,

Petitioners,

vs.

COMMISSIONER OF INTERNAL
REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

RICHARD D. HOBBET
HERMAN E. FRIEDRICH
FRANK J. PELISEK
Counsel for Petitioners

626 E. Wisconsin Ave.
Milwaukee 2, Wisconsin

Of Counsel:
MICHAEL, BEST & FRIEDRICH

HAMMERSMITH-KORTMEYER CO. MILWAUKEE

INDEX

	Page
Opinions Below	1
Jurisdiction	2
Question Presented	2
Statutes and Regulations Involved	2
Statement	3
Reasons for Granting Writ	6
Conclusion	15
Appendix A	16
Appendix B	23

CITATIONS

Cases:

Bookwalter v. Centropolis Crusher Co., 281 F. 2d 798 (8th Cir. 1960) 14

Centropolis Crusher Co. v. Bookwalter, 61-2 U.S.T.C. ¶9641 (W. D. Mo. 8/14/61) 14

Standard Realization Company v. United States, 289 F. 2d 247 (7th Cir. 1961) 14

United States v. Cannelton Sewer Pipe Company, 364 U.S. 76 (1960) 6,7,8,9,10,11,12,13,14

United States v. Cherokee Brick & Tile Company, 218 F. 2d 424 (5th Cir., 1955) 7, 8

United States v. Merry Brothers Brick and Tile Co., 242 F. 2d 708 (5th Cir., 1957) 7, 8

Page

United States v. Pacific Clay Products, 285 F. 2d 215 (9th Cir., 1960) 14

United States v. Portland Cement Co., 61-2 U.S.T.C. ¶9624 (10th Cir., 8/27/61) 8, 14

United States v. Sapulpa Brick and Tile Corporation, 239 F. 2d 694 (10th Cir., 1957) 8

Statutes:

Internal Revenue Code of 1939:
Sec. 23(m) (26 U.S.C. 1952 ed., Sec. 23(m)).... 2

Sec. 114(b) (26 U.S.C. 1952 ed., Sec. 114(b)) 2, 6, 12, 13

Internal Revenue Code of 1954:
Sec. 613 (26 U.S.C. 1958 ed., Sec. 613).....2, 12

Miscellaneous:

Standard Industrial Classification Manual, Executive Office of the President, Bureau of the Budget, 1957 9

Treasurer Regulations 118 (1939 Code)
Sec. 39.23(m)-1 .....2, 12

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1961

No.

ALBIN C. HALQUIST and
MADELINE E. HALQUIST,

Petitioners,

vs.

COMMISSIONER OF INTERNAL
REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Albin C. Halquist and Madeline E. Halquist petition for a writ of certiorari to review the judgment of the Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinion of the Tax Court is reported at 33 T.C. 304. The opinion of the Court of Appeals (Appendix A, infra, pp. 16-22) is reported at 291 F.2d 49.

JURISDICTION

The judgment of the Court of Appeals was entered on May 5, 1961. (Appendix A, infra 22) Rehearing was denied on June 5, 1961. (Appendix A, infra 22a) The time for filing a petition for a writ of certiorari was extended by order of Mr. Justice Clark, to and including October 5, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTION PRESENTED

The question presented by this case is whether taxpayers who engage in the quarrying of dolomitic limestone must treat as their first commercially marketable product for purposes of their allowance for mineral depletion, irregular shaped blocks of stone for which there is no market, either profitable or nonprofitable anywhere in the country and upon which their extractive and concentrating processes have not been completed.

STATUTES AND REGULATIONS INVOLVED

The taxable years 1951-1954 are involved and therefore the applicable statutory provisions involved are Sections 23(m) and 114(b) of the Internal Revenue Code of 1939 and Section 613 of the Internal Revenue Code of 1954, the pertinent parts of which are printed in Appendix B, infra, pp. 23-29. The Treasury Regulations involved are Section 39.23(m)-1 of Treasury Regulations 118. Regulations under the 1954 Code pertinent hereto have not yet been promulgated.

STATEMENT

Petitioners, during 1951 through 1954, operated two stone quarries in Waukesha County, Wisconsin, engaging in the business of extracting stone from the ground, concentrating it by removal of waste, and selling it in the form of dimension or ornamental stone, (hereinafter referred to as dimension stone). They also engaged in a crushed stone operation from a part of their quarry not suitable for dimension stone. Dimension stone consists of blocks and slabs of natural stone cut to definite shapes and sizes for building stone, monumental stone, paving blocks, curbing and flagging. Flagging or flagstone is a dimension stone of irregular shape approximately two inches thick and having at least one flat side, which is used for landscape purposes. Drywall is a dimension stone which is generally eight to ten inches in width and about two to four inches in height which is generally used for laying up retaining walls without mortared joints.

The stone quarried for use as dimension stone is removed from the face of the quarry by small charges of black powder which loosen the stone along its natural bed layers and seam faces. These layers are then removed from the face of the quarry by hand. Larger pieces are broken by hand methods. The stone is then sorted into roughly three categories—waste, flagstone and drywall, and stone suitable for veneer stone. Stone selected for flagstone and drywall is set aside and stone suitable for veneer stone is carried to hand cutters located around the edge of the quarry bed. The cutters cut and break away waste, leaving stone in pieces having roughly regular shapes and suitable for use as veneer stone, a process closely analogous to concentration processes used in metal mines. This veneer stone constitutes the principal product

produced by the cutters of Halquist Lannon Stone Company during all of the taxable years.

The production of dimension stone was accomplished primarily by the use of hand tools. During the latter part of 1954 petitioners purchased a large diamond saw which was used to perform a very small part of the cutting operation.

Of the stone selected for the production of veneer stone another 40 to 50% by weight was lost in the cutting process necessary to produce a marketable dimension stone.

The Lannon district in Waukesha County, Wisconsin contains a number of small quarry operations. During the years 1951 through 1954 the average dimension stone quarry in this area employed about five workers although there were a substantial number of even smaller quarries. They all used these same methods employed in quarrying dimension stone.

Petitioners did not and could not sell stone from their quarries until it had been processed into dimension stone, the first point at which it had a roughly regular dimension. No commercial stone processor purchases or processes irregular shaped blocks of stone such as those quarried in petitioners' quarry. The Tax Court correctly found that a negligible number of rough blocks were purchased by petitioners from a very few quarries in the area. But the undisputed facts indicate that blocks of this type were not available in petitioners' deposit.

There are several reasons, none of which are related to profitability, why no commercial stone processor purchases rough blocks of like kind or grade as that quarried by petitioners. As indicated, there is a substantial waste

factor in the processing of Lannon stone. This factor would cause processors to incur substantial excess shipping costs as well as creating a problem as to the disposal of this enormous amount of waste. In addition delay in processing the stone would permit its natural moisture to evaporate, making the stone far more difficult to work. Even more important is the fact that production of stone requires a steady amount of raw materials. A steady supply of stone from quarries in the Lannon area which would be suitable for commercial processing does not exist. As a final reason it should be noted that commercial processors require large blocks of uniform shape and dimension which can be processed by large scale machine operations. Petitioners' quarries do not yield blocks which are large enough for such processing nor can the stone which is available be readily worked by the planers which are a vital part of a commercial processor's operation. There is no use to which the stone quarried by petitioners can be put until it is processed into a rough dimension stone.

The Commissioner has determined that the first commercially marketable product of petitioners' quarry upon which the depletion is to be calculated is irregular shaped blocks of stone before any hand cutting or breaking operations are applied. The Tax Court found that petitioners' treatment processes were the ordinary treatment processes performed by dimension stone miners and that petitioners' first commercially marketable product was stone processed to a roughly regular dimension and ready for shipment at the quarries whether such stone was flagstone, drywall or veneer stone (which differ primarily in thickness —a natural attribute of the stone in the ground). The Court of Appeals reversed the Tax Court and adopted the Commissioner's position on appeal.

REASONS FOR GRANTING WRIT

A. A decision by this Court in a second depletion case with facts substantially different from those in *United States v. Cannelton Sewer Pipe Company*, 364 U.S. 76 (1960) is vital in order to sharply interpret the depletion statutes under both the 1939 and 1954 Codes. Many questions involved in the practical application of the depletion provisions to varying fact situations have been left unanswered by that decision. *Cannelton* substantially limits the depletion claims available to taxpayers but it places no reins on an otherwise unbridled administrative interpretation of the statutes by the Commissioner. This case is illustrative of such uncontrolled administrative interpretation of the statute which is in conflict with the plain meaning of the statute, the Commissioner's Regulations and the Commissioner's own argument to this Court in the *Cannelton* case.

Cannelton was a case of extreme facts which provided the Commissioner with an excellent vehicle with which to present his interpretation of the depletion statutes. But *Cannelton* was not the typical depletion case; it was the extreme. The opinion, however, was broad in its discussion. Such breadth of discussion from this Court creates the danger that lower courts will ignore the statute itself. The instant case is an example of such attitude.

Thus whether this Court affirms or reverses this case, it would clarify a statute and regulation which now are confusing taxpayers and administrators,* as well as the lower courts.

Cannelton, in adopting the Commissioner's analogy that an integrated miner-manufacturer sells to himself, created a situation in which taxpayers cannot possibly

---

*The 1954 Code regulations which would be applicable here have not yet been promulgated in final form.

guess the "correct" application of the law to themselves' if this is coupled with the idea of the Seventh Circuit that *Cannelton* does not consider as significant the actual market, the actual trade or commerce in the particular mineral, or one of like kind, of the taxpayer. In this vacuum the Commissioner can assert any arbitrary cutoff point for any mine, saying that at such point the mineral is fit for industrial use or consumption (i.e., further processing) and therefore, taxpayer-miner is an integrated miner-manufacturer selling to himself and creating the "commercial market" for his mineral. This is no idle "chamber of horrors." This is what has been done in the *Halquist* case.

Administrative certainty and practicalities are important, but equally important to the just operation of our tax laws is that taxpayers be given some guide to the meaning of a law under which they must assess themselves a tax and make day to day business decisions. This case illustrates that *Cannelton* cannot do this because of its combination of a narrow holding on extreme fact situation and broad generalities in dicta which, outside the context of the holding of the case, furnishes no directed assistance to the determination of a cut-off point.

B. The facts in the instant case furnish an excellent vehicle upon which this Court may further define the meaning of the statute. The following questions, which need resolution, can be answered by this case.

1. Were *Merry Bros.*, 242 F. 2d 708 (5th Cir. 1957) and *Cherokee Brick*, 218 F. 2d 424 (5th Cir.) correctly decided and are they still authoritative (contrary to the Commissioner's claim)?

In this case there were no sales of the product at the cut-off point by anyone in the industry. The question is

not one of profit or lack thereof.* This gives the Court the opportunity to consider the holdings in *Merry Bros.* and *Cherokee Brick* which it distinguished in *Cannelton.* This has already caused confusion in the Tenth Circuit where the Court of Appeals was unable to instruct the District Court on remand as to the authority of *Sapulpa Brick & Tile,* 239 F. 2d 694 (10th Cir. 1957) which was based on those cases. See *United States v. Portland Cement Co.,* 61-2 U.S.T.C. ¶9624 (10th Cir. Aug 27, 1961).

2. The processes claimed to be ordinary treatment processes are "mining" processes within the Commissioner's definition of "mining" and "manufacturing" as stated in his brief to this Court in the *Cannelton* case. Is a cut-off point which excludes mining processes permissible?

In *Cannelton* the Commissioner indicated that "mining" included "certain ordinary preparatory processes, *employed after extraction, to separate the valuable constituent from waste matter* so as to put it in the form or grade fit for use." The Commissioner also noted that:

> "To miners 'mining' is a 'selective' process of obtaining or winning 'a marketable product'. It is selective because, in addition to the mineral for which a deposit is worked, the material mined 'usually carries one or several waste minerals' and the 'market or use requirement' ordinarily necessitates separation of the valuable mineral, in varying degrees of purity or in controlled mixtures of the components. This separation is accomplished by various 'methods of treatment' or 'treatment' depending upon the type of mineral, which do not destroy the physical and chemical identity of the mineral."

Petitioners use hand tools to break away waste material from the valuable constituent, the dimension stone, which

*Nor is there any question that the stone has value as substantial royalties are paid for the privilege of mining this type of stone.

occurs naturally in the ground. This puts the stone in a form or grade fit for use. Clearly the stone is not fit for use until that waste has been eliminated. Breaking away this waste material does not destroy the physical or chemical identity of the dimension stone. Thus, the processes employed by petitioners are mining processes. As such the cut-off point for depletion purposes is not reached until these processes have been completed.

The Commissioner also notes in his Supreme Court brief in *Cannelton* that his definition of mining conforms to the Federal Government's *Standard Industrial Classification Manual* which defines "mining" in accordance with the existing structure of the American economy. The Manual states:

> " 'The term "mining" is also used in the broad sense to include quarrying, well operation, milling (crushing, screening, washing, flotation, etc.), and other preparation needed to render the material marketable.' "
>
> "Such processing or preparation is entirely discrete from manufacturing. As the Manual states (p. 43), the treatment proscesses employed in mining to obtain a marketable mineral product 'are not considered manufacturing' which, in contradistinction to mining, involves 'the mechanical or chemical transformation of inorganic and organic substances into new products.' "

It is obvious that breaking away waste from stone to obtain pieces usable for a building material does not involve manufacturing within the meaning urged by the Government in *Cannelton*. There has been no mechanical transformation into new products. There has been merely a concentrating of the mineral product, a recognized mining process.

3. There is no market, profitable or non-profitable for irregular shaped blocks of Lannon stone. Is such a market necessary under the statute?

To determine that no market is necessary is to read out of the law the term "commercially marketable." That statutory phrase requires the presence of a commercial market. None exists for petitioners' stone at the rough block stage. Yet that is the point at which the Court of Appeals would cut off petitioners' depletion base. Such determination emasculates the depletion statute.

4. The Court of Appeals has determined that petitioners sell to themselves. Can this furnish a cut-off point when there is no other guide? If so, what determines the point at which the sale is made? There can be no reference to some outside market since it is shown that none exists.

5. The Court of Appeals also makes reference to the sales of a "typical miner". But petitioners are not owners of a typical mineral deposit. Thus, how "similar" do miners have to be in order to furnish an industry reference point? If petitioners are to be likened to Indiana limestone producers, who appear to occupy "typical" status (according to the Court of Appeals), then the processes used by them must be examined. And how is a "typical" miner's situation to be applied in determining a cut-off point for a nontypical miner?

The above discussion points up several of the many questions left unanswered by *Cannelton* due to its particular factual situation. The instant case provides a factual situation on the other end of the spectrum. Here the facts would appear to favor taxpayer while in *Cannelton* the facts clearly favored the Commissioner. This

Court now has an opportunity to fill in the gaps left by the *Cannelton* decision in the interpretation of the depletion statute.

C. This case is important to many mine operations other than petitioners'. During the years in dispute and continuing to the present the average dimension-stone quarry operation in the Lannon district employed about five workers, although there were a number of even smaller quarries. In several instances a single individual will lease quarry property and extract the stone. These quarry operators are small in size but many in number. In addition to miners in the area near Lannon, Wisconsin this case will have substantial application to all stone quarry operators throughout the United States. The determination made by the Court of Appeals will, in many instances, unjustly and improperly limit the statutory depletion allowance for quarry operators.

The principles in this case and the answers to the issues raised here will also affect miners outside of the dimension stone industry. Under the determination of the Court of Appeals no miner is safe from the arbitrary administrative determination that he sells to himself at some point in his processing, regardless of the marketability of his mineral product at such point.

D. The Tax Court's decision was correct and The Seventh Circuit erred in reversing it.

By no meaningful test or interpretation is it possible to conclude that the Tax Court erred in this case. Its findings are clear that there is no commerce in dimension stone of this type prior to the trimming of the stone to its first roughly regular dimension. There being no commerce there can be no market, let alone a commercial

market which implies at least some sufficiency in size and scope to permit sales on something other than an individually negotiated basis. The Commissioner never directly challenged these findings and the Seventh Circuit brushed them aside by reference to sales which the evidence showed to be nominal.

Cannelton had clearly indicated that actual sales of the mineral in question were required to find a commercial market. Not only was this specifically stated but several cases which turned on this fact were specifically distinguished. Nevertheless the Seventh Circuit in this case determined a cut-off point in the absence of sales, referring to *Cannelton's* dicta of an integrated miner-manufacturer selling to himself.

The Tax Court's findings were clear that the processes used by petitioners were the ordinary ones used in their industry.

Furthermore, the description of the processes included in ordinary treatment processes contained in §114(b)(4)(B)(iii) and (iv), 1939 Code,* apply in this case. It makes no difference here whether (iii) or (iv) applies because the Regulations provide, in §39.23(m)-1(F)(3),

> "For the purposes of subdivisions (iii) and (iv) . . ., the terms 'concentration' or 'concentrating' mean the process of eliminating waste or of separating two or more minerals or ores."

Clearly at the Seventh Circuit's arbitrary cut-off point these concentrating processes have not been completed as one-half of the stone remaining is waste. Furthermore, the subsequent processes separate crushed stone from dimension stone and they are recognized as separate

---

*The 1954 Code equivalent is § 613(c)(4)(C) and (D).

mineral categories under the 1954 Code.* The Seventh Circuit simply ignored this *express* statutory provision and the explicit Regulations thereunder.

What remains to support the reversal of the Tax Court? Only broad generalizations lifted out of context from the *Cannelton* case.

One, that petitioners were integrated miner-manufacturers, selling stone to themselves. But this so-called test depends on delimiting the spheres of "mining" and "manufacturing" with exactness. Otherwise any miner can be said to sell to himself at any stage of processing. But this begs the question because the statute defines mining. Nevertheless if an attempt is made to delimit these terms outside the frame of the statute and bootstrap this into an interpretation of the statute's definition of mining, *Cannelton* still needs clarification. In this case petitioners have shown that their processes which were excluded by the Seventh Circuit were mining, not manufacturing processes, within the definition given by the Commissioner to this Court in *Cannelton*. The Commissioner virtually conceded this in his reply brief to the Court of Appeals, stating that "If this [an interpretation of the statute based on a mining-manufacturing test] were our position, there could possibly be some merit to the taxpayers' contention."

Two, "fit for industrial use or consumption." Though this may be descriptive of a product it is not definitive. Any product, at *any* stage of processing, can be said to be fit for industrial use or consumption if this simply means more processing.

Thus the Seventh Circuit's decision leaves the depletion statutes in chaos for a large three state area and it

---

*§ 613(b)(5) and (6).

thereby joins the admitted confusion of the courts in other circuits.

In the Seventh Circuit alone, this case stands opposed to *Standard Realization*, 289 F.2d 247 (7th Cir. 1961) decided by that same court only several weeks earlier. That case demands some actual sales to pick a cut-off point. This one does not.

The Eighth, Ninth and Tenth Circuits found themselves unable to resolve depletion litigation coming before them following *Cannelton*.

> *Bookwalter v. Centropolis Crusher Co.*, 281 F.2d 798 (8th Cir. 1960);
>
> *United States v. Pacific Clay Products*, 285 F.2d 215 (9th Cir. 1960);
>
> *United States v. Portland Cement Co.*, 61-2 U.S.T.C. ¶9624 (10th Cir. Aug. 27, 1961).

In each case there has been a remand to the district court without any more instruction than broad and ambiguous generalizations. The district court has now decided *Centropolis*, 61-2 U.S.T.C. ¶9641 (Mo. W.D. Aug. 14, 1961) and has taken the same view of *Cannelton* that we urged to the Seventh Circuit without success in this case, i.e., that *Cannelton* simply rejected the profitability test. Thus there is a distinct possibility of a conflict between the Eighth and Seventh Circuits developing.

CONCLUSION

For the reasons stated above this case is worthy of review by this Court.

Respectfully submitted,

RICHARD D. HOBBET
HERMAN E. FRIEDRICH
FRANK J. PELISEK
Counsel for Petitioners

626 E. Wisconsin Ave.
Milwaukee 2, Wisconsin

Of Counsel:
MICHAEL, BEST & FRIEDRICH

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Appeal from the Tax Court of the United States

No. 13107

COMMISSIONER OF INTERNAL REVENUE,

Petitioner

vs.

ALBIN C. HALQUIST AND MADELINE E. HALQUIST,

Respondents

May 5, 1961

Before HASTINGS, Chief Judge, and KNOCH and CASTLE Circuit Judges.

KNOCH, Circuit Judge.

The facts in this case are largely stipulated or undisputed. During the taxable years 1951 through 1954, respondents Albin C. Halquist and Madeline E. Halquist, his wife, as a partnership, Halquist Lannon Stone Company (hereinafter called "Halquist") engaged in the business of removing stone from two quarries in Waukesha County, Wisconsin.

This stone was sold in the form of two products: crushed stone and "dimension" stone[1] of various shapes Halquist's own quarries.

---

[1] "Dimension" stone includes blocks and slabs of natural stone used for building, monuments, paving, curbing and flagging.

and sizes. Halquist also bought, processed and sold some dimension stone from other quarries. There was evidence that these stones usually were of a type not available in

In the Halquist quarries, the uppermost strata consist of thinly bedded slabs broken by seams or joints which result in blocks of varying size from a few square feet up to 25 or 50 square feet, and from about two to six inches in thickness. Dimension stone for building is taken from these upper strata. The uppermost level produces a thinner layer of stone for flagstones and drywall.[2]

The lower strata are markedly different stone from these upper levels and are suitable only for crushed and broken stone.

Halquist removes the stone from the upper strata in its natural shapes and sizes. The stone thus removed is sorted into three classes: (1) waste; (2) flagstone and drywall, requiring mere breaking and splitting; and (3) stone suitable for process as dimension stone.

The waste is dumped into the pit of the quarry from which it is picked up and fed to the crusher.

The stones of the third class are carried to cutters, about 50 to 250 feet away from the place where the stone is quarried. The cutters then cut and break the stone into regular shapes of random lengths and heights suitable for use as veneer stone, a form of dimension stone in which the width is about the thickness of a wall to be built usually about four inches, the length

---

[2] Flagstones are irregularly shaped, about two inches thick, with at least one flat side, and are used for landscaping. Drywall, about eight to ten inches in width and two to four inches in height, is usually used for retaining walls.

is the horizontal measurement of the stone in the wall, and the height is its vertical measurement in the wall. In the processes of cutting, for which various tools and methods have been used, 40 to 50% of the weight is lost and becomes waste which is sold as crushed stone.

Halquist contends that veneer stone is its principal product; that production and sale of crushed stone and of agricultural limestone is a secondary operation, in part dictated by proper quarry housekeeping to dispose of the waste along with the stone of the lower levels which is suitable only for crushed stone.

The applicable statutes[3] provide for percentage depletion allowance of the gross income from mining. "Mining "is limited to the ordinary treatment processes normally applied by mine owners and operators to obtain the commercially marketable mineral product or products. In computing its depletion allowance, Halquist used the gross proceeds (less delivery costs and discounts) from the sale of its crushed and broken stone, its flagstone and drywall, and its fully processed veneer dimension stone.

The Commissioner took the position that the gross income from mining was limited in the case of these quarries to the value of the rough uncut stone, or alternatively, (1) that the gross income be computed as though all the stone had been sold as crushed stone, or (2) that flagstone and drywall be considered the first commercially marketable products obtained from the upper levels.

---

[3]Internal Revenue Code, 1939 § 114(b)(4), 26 U.S.C.A., § 114(b)(4) — 10%.

Internal Revenue Code, 1954, § 613, 26 U.S.C.A. § 613 — 15%.

The Tax Court redetermined all deficiencies as requested by Halquist, and the Commissioner appealed to this Court.

The Tax Court considered this case after our decision in *Cannelton Sewer Pipe Co. v. United States*, 7 Cir., 1959, 268 F. 2d 334, but before the U. S. Supreme Court had reversed that decision in *United States v. Cannelton Sewer Pipe Co.*, 1960, 364 U.S. 76, 80 S. Ct. 1581, 4 L. Ed. 2d 1581.

Accordingly the Tax Court gave considerable weight to the theory that a taxpayer must be in a position to sell his product at a profit before it can be "commercially marketable." That theory has now been rejected by the U. S. Supreme Court in *Cannelton. Standard Realization Co. v. United States*, 7 Cir., 289 F. 2d 247.

There is no dispute with reference to receipts from the crushed stone or the flagstone and drywall phases of the operation. These are to be included in the depletion base without reduction. The sole question before us concerns the processing of the dolomite dimension stone (taken from the upper faces of the quarries) into the veneer building stone, which Halquist considers to be its principal product.

On the undisputed facts, it appears clear that Halquist's basic mineral product from these upper faces is the uncut block of dimension stone prior to its delivery to the cutters who process it into veneer stone. Halquist asserts that, unlike the products involved in *Cannelton* and in *Great Bend Brick & Tile Co. v. U. S.*, D.C. Kan., 194 F. Supp. 309 on which the Commissioner relies, Halquist's rough uncut blocks cannot be sold in substantial quantities because such sale would entail impractical

transportation of material which will ultimately prove to be about 50% waste.

However, in the light of *Cannelton*, we may not include processing the rough, uncut blocks into veneer stone under the heading of "mining" processes. Lacking local or area sales of the precise stone in Halquist's quarries to establish the cutoff point when the mineral first becomes suitable for industrial use or consumption, we must have recourse to the recognized branch of the mining industry to which Halquist may be assigned.

The evidence supports a conclusion that Halquist's operations deal, in effect, with two types of quarries: one yielding dimension stone, and the other yielding crushed stone. The evidence further shows that in typical dimension stone mining, rough blocks are removed and sold for process in substantial quantities. *Cannelton* prescribes an objective, standard cutoff point to be uniformly applied throughout each particular branch of the mining industry.

Because of certain physical properties in most of Halquist's stone, the high percentage of waste makes it uneconomical for cut-stone processors to purchase it in its rough uncut state and transport it for any extensive distance. In effect Halquist, therefore, sells its rough uncut stone to itself for cutting and completion processing within the very short distance from the place where it is quarried. The evidence shows that where large enough dolomite blocks were available from the same formation as that worked by Halquist, those blocks were sold in the rough uncut state to processors who engaged in cutting operations.

In *Cannelton*, the taxpayer sold none of its product in its raw state because, due to its high cost of operation, it could not compete at a profit with other producers. The whole theory of the depletion allowance is to compensate for depletion of the mineral deposit.

The Tax Court's judgment must, therefore, be reversed. The cause is remanded with directions to compute Halquist's percentage depletion base on its receipts from the sale of crushed stone (as adjusted to avoid duplication of receipts from sale of the waste from cutting veneer stone, which waste is sold as crushed stone); receipts from sale of flagstone and drywall; and an allocation of the receipts from the sale of building stone attributable to the rough, uncut blocks as removed from the quarry prior to delivery to cutters for processing.

Reversed and remanded.

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
No. 13107

COMMISSIONER OF INTERNAL REVENUE, *Petitioner,*

vs.

ALBIN C. HALQUIST and MADELINE E. HALQUIST, *Respondents.*

Friday, May 5, 1961

Before

Hon. JOHN S. HASTINGS, Chief Judge
Hon. WIN G. KNOCH, Circuit Judge
Hon. LATHAM CASTLE, Circuit Judge

Petitions for review of decisions of the Tax Court of the United States.

This cause came on to be heard on the transcript of the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decisions of the Tax Court of the United States entered in this cause on February 19, 1960, be, and the same are hereby, REVERSED, and that this cause be, and it is hereby, REMANDED to the said Tax Court of the United States with directions to compute Halquist's percentage depletion base on its receipts from the sale of crushed stone (as adjusted to avoid duplication of receipts from sale of the waste from cutting veneer stone, which waste is sold as crushed stone); receipts from the sale of flagstone and drywall; and an allocation of the receipts from the sale of building stone attributable to the rough, uncut blocks as removed from the quarry, prior to delivery to cutters for processing, in accordance with the opinion of this Court filed this day.

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

No. 13107

COMMISSIONER OF INTERNAL REVENUE — *Petitioner,*

vs.

ALBIN C. HALQUIST and MADELINE E. HALQUIST, — *Respondents.*

Monday, June 5, 1961

Before

Hon. JOHN S. HASTINGS, Chief Judge
Hon. WIN G. KNOCH, Circuit Judge
Hon. LATHAM CASTLE, Circuit Judge

Petition for review of a decision of the Tax Court of the United States

It Is Hereby Ordered by the Court that the petition for a rehearing of this cause be, and the same is hereby DENIED.

APPENDIX B

1939 INTERNAL REVENUE CODE

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * *

(m) Depletion. — In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion * * *

* * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * *

(b) Basis for Depletion. —

(1) General rule. — The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * *

(4) Percentage depletion for coal and metal mines and for certain other mines and natural mineral deposits. —

(A) In general. — The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be —

(i) in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, and bromine, 5 per centum,

(ii) in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, calcium carbonates, and magnesium carbonates, 10 per centum,

(iii) in the case of metal mines, aplite, bauxite, fluorspar, flake graphite, vermiculite, beryl, garnet, feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball clay, sagger clay, china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite, thenardite, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, diatomaceous earth, metallurgical grade limestone, chemical grade limestone, and potash, 15 per centum, and

(iv) in the case of sulfur, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph.

(B) Definition of gross income from property. — As used in this paragraph the term 'gross income from the property' means the gross income from mining. The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported

a greater distance to such plants or mills. The term 'ordinary treatment processes', as used herein, shall include the following: (i) in the case of coal — cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur — pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product — sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; (iv) in the case of lead, zinc, copper, gold, silver, or flurspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product — crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 450 and 453."

1954 INTERNAL REVENUE CODE

"SEC. 613. PERCENTAGE DEPLETION.

[Sec. 613(a)]

(a) General Rule. — In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in re-

spect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

[Sec. 613(b)]

(b) Percentage Depletion Rates. — The mines, wells, and other natural deposits, and the percentages, referred to in subsection (a) are as follows:

(1) 27½ percent — oil and gas wells.

(2) 23 percent —

(A) sulfur and uranium; and

(B) if from deposits in the United States — anorthosite (to the extent that alumina and aluminum compounds are extracted therefrom) asbestos, bauxite, beryl, celestite, chromite, corundum, fluorspar, graphite, ilmenite, kyanite, mica, olivine, quartz crystals (radio grade), rutile, block steatite talc, and zircon, and ores of the following metals: antimony, bismuth, cadmium, cobalt, columbium, lead, lithium, manganese, mercury, nickel, platinum and platinum group metals, tantalum, thorium, tin, titanium, tungsten, vanadium, and zinc.

(3) 15 percent — ball clay, bentonite, china clay, sagger clay, metal mines (if paragraph (2)(B) does not apply), rock asphalt, and vermiculite.

(4) 10 percent — asbestos (if paragraph (2)(B) does not apply), brucite, coal, lignite, perlite, sodium chloride, and wollastonite.

(5) 5 percent —

(A) brick and tile clay, gravel, mollusk shells (including clam shells and oyster shells), peat, pumice, sand, scoria, shale, and stone, except stone described in paragraph (6); and

(B) if from brine wells — bromine, calcium chloride, and magnesium chloride.

(6) 15 percent — all other minerals (including, but not limited to, aplite, barite, borax, calcium carbonates, refractory and fire clay, diatomaceous earth, dolomite, feldspar, fullers earth, garnet, gilsonite, granite, limestone, magnesite, magnesium carbonates, marble, phosphate rock, potash, quartzite, slate, soapstone, stone (used or sold for use by the mine owner or operator as dimension stone or ornamental stone), thenardite, tripoli, trona, and (if paragraph (2)(B) does not apply) bauxite, beryl, flake graphite, fluorspar, lepidolite, mica, spodumene, and talc, including pyrophyllite), except that, unless sold on bid in direct competition with a bona fide bid to sell a mineral listed in paragraph (3), the percentage shall be 5 percent for any such other mineral when used, or sold for use, by the mine owner or operator as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes. For purposes of this paragraph, the term 'all other minerals' does not include —

(A) soil, sod, dirt, turf, water, or mosses; or

(B) minerals from sea water, the air, or similar inexhaustible sources.

[Sec. 613(c)]

(c) Definition of Gross Income From Property. — For purposes of this section —

(1) Gross Income From The Property. — The term 'gross income from the property' means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) Mining. — The term 'mining' includes not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in

order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

(3) Extraction Of The Ores Or Minerals From The Ground. — The term 'extraction of the ores or minerals from the ground' includes the extraction by mine owners or operators of ores or minerals from the waste or residue of prior mining. The preceding sentence shall not apply to any such extraction of the mineral or ore by a purchaser of such waste or residue or of the rights to extract ores or minerals therefrom.

(4) Ordinary Treatment Processes. — The term 'ordinary treatment processes' includes the following:

(A) In the case of coal — cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

(B) in the case of sulfur recovered by the Frasch process — pumping to vats, cooling, breaking, and loading for shipment;

(C) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product — sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment;

(D) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product — crushing, grinding, and beneficiation by

concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores; and

(E) the pulverization of talc, the burning of magnesite, and the sintering and nodulizing of phosphate rock."

INCOME TAX REGULATIONS 118

§39.23(m)-1.

"(d) When used in §§39.23(m)-1 to 39.23(m)-19, inclusive —

* * *

(4) The term 'minerals' includes ores of the metals, coal, oil, gas, and such nonmetallic substances as abrasives, asbestos, asphaltum, barite, bauxite, bentonite beryl, borax, building stone, cement rock, china clay, clay, crushed stone, feldspar, fluorspar, fuller's earth, gilsonite, graphite, gravel, gypsum, lepidolite, limestone, magnesite, marl, mica, mineral pigments, peat, potash, precious stones, pyrophyllite, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, spodumene, sulfur, talc, thenardite, trona, and vermiculite.

* * *

(e)(2) In the case of a crude mineral product other than oil and gas, 'gross income from the property,' as used in section 114(b)(4)(A), means the gross income from mining. The term 'mining' as used herein includes not only the extraction of ores or minerals from the ground but also the ordinary treatment processes which are normally applied by

the mine owners or operators to the crude mineral product after extraction in order to obtain the commercially marketable mineral product or products. The term 'mining' as used herein also includes so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles, and, if the Commissioner finds that both the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills, the transportation over such greater distance.

* * *

(3) If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, 'gross income from the property' means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, 'gross income from the property' means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation,

other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

(4) In case any of the ordinary treatment processes are not applied in the immediate vicinity of the mining district in which the mine is located, costs incurred for transportation to the processing location and, if transported by the taxpayer, the proportionate profits attributable to transportation, should be subtracted from the sale price of the product to determine 'gross income from the property.' In determining 'gross income from the property', the sale price of the product shall not be reduced by the costs and proportionate profits attributable to the transportation which is treated for such taxable year as mining, that is, so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles (or, if the Commissioner finds that both the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills, such greater distance). Where such plants or mills are in excess of 50 miles (or of such greater distance) from the point of extraction from the ground, then costs incurred for transportation in excess of 50 miles (or of such greater distance) to the treatment plant and, if transported by the taxpayer, the proportionate profits attributable to such excess transportation should be subtracted from the sale price of the product to determine 'gross income from the property'. In the absence of methods which will clearly reflect costs attributable to such excess transportation shall be an amount which is in the same ratio to the costs of the various phrases of transportation, the costs incurred for the total transportation to the treatment plant as the transportation included within the

term 'mining' is to such total transportation. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation other than the computation of profits proportionate to cost clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

(5) In all cases there shall be excluded in determining the 'gross income from the property' an amount equal to any rents or royalties which were paid or incurred by the taxpayer in respect of the property and are not otherwise excluded from the 'gross income from the property.' If royalties in the form of bonus payments have been paid in respect of the property in any taxable year ending prior to December 31, 1939, the amount excluded from 'gross income from the property' for the current taxable year on account of such payments shall be an amount equal to that part of such payments which is allocable to the product sold during the current taxable year. If advanced royalties have been paid in respect of the property in any taxable year ending on or after December 31, 1939, the amount excluded from 'gross income from the property' for the current taxable year on account of such payments shall be an amount equal to the deduction for such taxable year taken on account of such payments pursuant to § 39.23 (m)-10(e).

(6) Rents and royalties paid or incurred by a taxpayer with respect to coal shall be excluded from the 'gross income from the property' without regard to the treatment under section 117 (k) (2) of such rents and royalties in the hands of the recipient.

(f) (1) The term 'ordinary treatment processes,' as used in §§ 39.23 (m)-1 to 39.23 (m)-19, inclusive, shall include the following:

(i) In the case of coal — cleaning, breaking, sizing, and loading for shipment;

(ii) In the case of sulfur—pumping to vats, cooling, breaking, and loading for shipment;

(iii) In the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering (agglomerating by incipient fusion) to bring to shipping grade and form, and loading for shipment;

(iv) In the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and minerals which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity), flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation, or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the mineral. The furnacing of quicksilver ores is included in the term 'ordinary treatment processes.' The following processes are not included in the term 'ordinary treatment processes': electrolytic deposition, roasting, thermal or electric smelting, refining, or substantially equivalent processes.

(2) In addition, a treatment effecting a chemical change, the blending with other material, a thermal action, and the fine pulverization, pressing into shape or molding, are not included in the term 'ordinary treatment processes' unless such processes are (i) otherwise provided for in subdivisions (i), (ii), (iii), or (iv) of subparagraph (1); (ii) necessary of incidental to the processes provided for in subdivisions (i), (ii), (iii), or (iv) of subparagraph (1); or (iii) necessary to bring the ores or minerals into condition or form suitable for shipment (for example, the agglomeration of concentrates).

(3) For the purposes of subdivisions (iii) and (iv) of subparagraph (1), the terms 'concentration' or 'concentrating' mean the process of eliminat-

ing waste or of separating two or more minerals or ores."

REGULATIONS UNDER THE 1954 CODE

The portion of the Regulations under the 1954 Code which would be pertinent to this action have not yet been adopted.